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The Conference Board

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THE UNITED STATES AS INTERNATIONAL DEBTOR

Some time during the second quarter of 1985, the United States, which had been a net creditor vis-a-vis the rest of the world for about 70 years, turned into a net debtor. For the first time since 1914, foreign-owned assets in the United States came to exceed U.S. international assets (labeled somewhat misleadingly "U.S. assets abroad").

On both sides of the ledger, these assets cover a wide range of claims or investments. They include official assets, such as the gold and foreign-currency holdings of the U.S. Treasury and U.S. government securities and U.S. bank deposits held by foreign central banks and governments. Other international assets of the U.S. government include foreign loans of the government and other official agencies, as well as the capital subscriptions to international financial institutions of which the United States is a member.

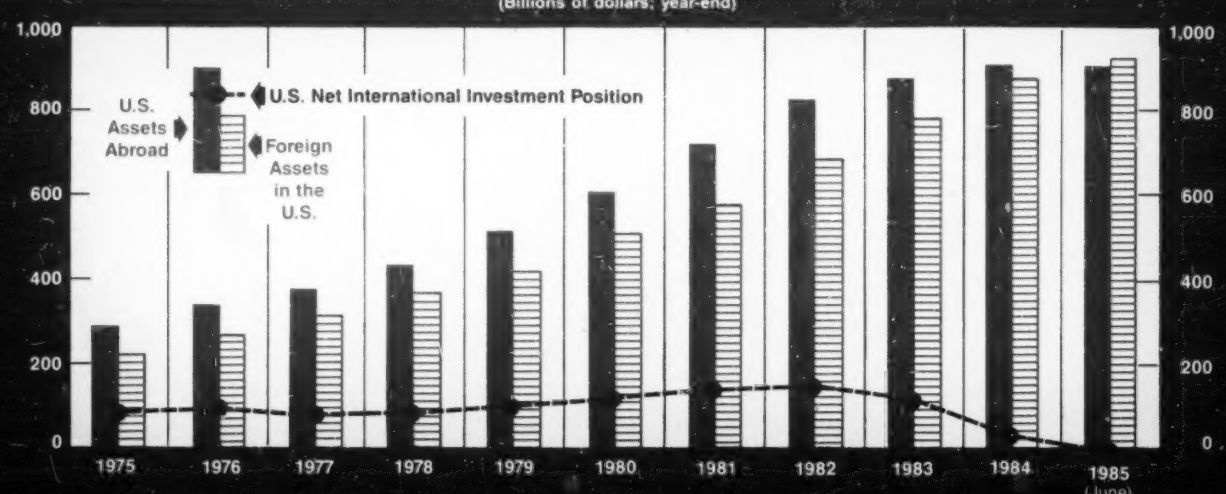
On both sides, these assets include foreign direct investment, in the form of industrial plant and equipment, other commercial and financial enterprises, and real estate. And they include, most prominently, what is called "other private assets." On the part of the United States, that term comprises U.S. ownership of foreign securities, foreign lending by U.S. banks, and foreign credit extended by U.S. businesses. On the part of foreigners, private assets cover the broad range of U.S. financial instruments—from bank deposits and CD's to long-term corporate and Treasury securities—that have long been favorites of foreign investors.

When all these various investments are netted out, the United States has now become a net debtor to the rest of the world. This shift is of course no more than a reflection of the large balance-of-payments deficits which this country has recorded for the past few years and which have had as their counterparts sizable "inflows" of foreign funds—more precisely, acquisitions of dollar assets by foreigners.

While the United States has become a debtor nation in that sense, it has not thereby joined the major international debtors among the developing countries. Statements that by the end

Chart 1: **International Investment Position of the United States**

(Billions of dollars; year-end)



of this year the United States would be the largest debtor country in the world or that around 1989 the U.S. external debt could easily exceed the total debt of *all* the developing countries ignore a number of important differences between this country's position in the world economy and the indebtedness of others that has been making headlines for the past few years.

Aspects of the U.S. International Investment Position

As Chart 1 shows, the U.S. position as an international creditor reached its peak at the end of 1982, at almost $150 billion. Given the vast range of different assets entering into that position, it is not surprising that the buildup to 1982 and the ensuing descent into debtor status have reflected major shifts in specific components, rather than broad overall swings.

Such shifts have included the sharp increase in U.S. foreign direct investment in the 1950's and 1960's ; sizable purchases of U.S. Treasury securities between 1970 and 1973 as foreign monetary authorities intervened heavily in the exchange markets toward the end of the fixed exchange-rate regime; sharp increases in U.S. bank lending abroad in 1981 and 1982 ; a marked drop in such lending and increased funding abroad by U.S. banks in 1983 and 1984; and, last year, record foreign purchases of both U.S. government securities and bonds floated abroad by U.S. corporations, plus a doubling of foreign direct investment flows to the United States. (In manufacturing investment alone, The Conference Board recorded 325 announcements last year, up from 280 in 1983.) In certain individual categories, the United States has retained a substantial creditor position (see Chart 2).

Still, the notion of this country's net international investment position is a statistical convention that needs to be interpreted with some care. That applies to some of its components as well.

On the assets side, for instance, U.S. gold holdings continue to be carried at $42.22 an ounce, the value set after the second dollar devaluation in February 1973. At that rate, U.S. gold holdings at the end of 1984 were carried at $11.1 billion. Valued at the free market price, however, their year-end value would have been $81.0 billion, thus boosting U.S. international assets by some $70 billion.

Also among U.S. international assets, direct foreign investment is carried at book, rather than market, value. While data on the true current replacement value of such investment are not available, an estimate can be made on the basis of the earnings from direct investment. In 1984, such earnings amounted to $28.8 billion—from which a capital value of about $350 billion has been derived, as against the published figure of $233 billion.

The liabilities side, on the other hand, may well be substantially understated. The U.S. balance of payments has been marked for some years now by a fairly large statistical discrepancy (formerly known as "errors and omissions") which, it is believed, hides unrecorded capital inflows of various kinds. For 1984 alone, that discrepancy amounted to $24.7 billion and for the 1979-1984 period as a whole to some $140 billion. If that number does mask inflows that have not been caught in the statistical net, the increase in foreign assets over the past few years has been consistently underrecorded and the United States would have become a "net debtor" to the rest of the world before 1985.

The Special Role of the Dollar

The factors entering into this country's international investment position thus are many and complex. This alone makes it inappropriate to compare the United States with the major debtors in the developing world. For one thing, for foreign direct investment in the United States—which grew more than sixfold in the ten years through 1984—the question of "owing" the equivalent to the foreign parent and having to pay it back eventually hardly arises.

More important, any genuine international "borrowing" by the United States is incurred and repaid in its own currency, the dollar. This is in sharp contrast to all other debtor countries, which have borrowed foreign currencies—mostly dollars—and, therefore, must service their loans in those currencies. To do so, these countries must first acquire sufficient foreign exchange, either by selling more to the rest of the world or by buying less, and to do so they generally have to tighten their belts. In other words, for the U.S. there is no risk of default.

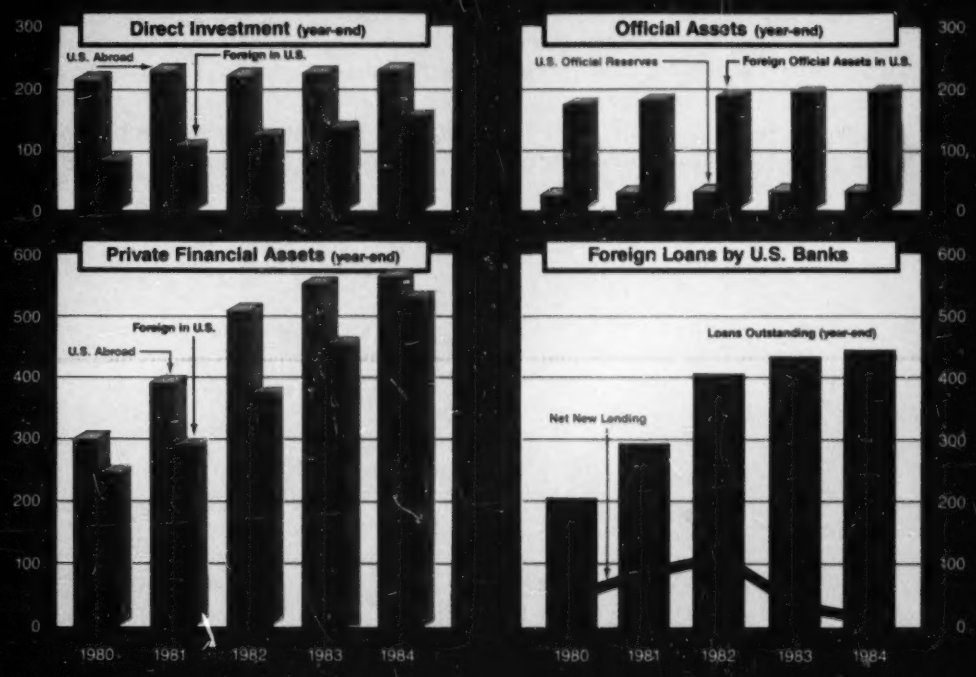
But above all, the vast foreign dollar holdings cannot be treated simply as "debt" or as amounts "owed" to foreigners, because of the special role of the dollar. The dollar remains the currency in which a major part of world trade is valued and paid for. It is also the principal international investment currency—thanks in large part to the size, openness, breadth, and liquidity of U.S. financial markets. Likewise, the dollar has remained the world's major reserve currency, accounting for close to three-quarters of official monetary reserves. In many countries the dollar serves, often illegally, as both a means of payment and a store of wealth, in preference to domestic currencies.

Because of the dollar's special role, foreigners always need to keep certain dollar balances to finance trade and to hold as investments and reserves. With the United States acting as the world's banker, the dollar functions as an intermediary between surplus and deficit countries, financing both the deficit of the United States and the deficits of others. Thus, the huge growth of foreign-owned dollar assets and the related expansion of the Eurodollar market do not necessarily represent a dollar "overhang" that eventually has to be paid off. The historical data do in fact show that foreign dollar

Chart 2

Selected Components of U.S. International Investment Position

Billions of Dollars



holdings have increased even in years when the United States' balance of payments was in surplus.

Implications of U.S. Debtor Status

Given the special role of the dollar, and hence the somewhat ambiguous nature of U.S. international indebtedness, there is no precise way in which to measure the ratio of total external debt to exports of goods and services that traditionally is computed for major debtor countries. (At the end of 1984, for instance, that ratio stood at 308 percent for the 10 largest debtors, ranging from 160 percent for Yugoslavia to 483 percent for Argentina.)

However, another important statistic—the so-called debt service ratio—can be computed for both the United States and other debtors. That ratio indicates the share of a country's receipts from exports of goods and services that has to be devoted to servicing its external debt; it has two parts—debt amortization and interest payments. For the United States, interest payments to foreigners, by both the private sector and the U.S. government , rose from $33.5 billion (or 9.8 percent of total exports) in 1980 to $58.3 billion (or 16.1 percent) last year. For the 10 major debtors, the interest-to-exports ratio last year was 31 percent, ranging from 11 percent for Nigeria to 56 percent for Argentina.

Even more to the point, last year's interest payments on foreign-owned financial assets in this country were equal to 1.6 percent of U.S. gross national product. In other words, almost one quarter of last year's real GNP growth (6.8 percent) had to be diverted to service our foreign liabilities. It is true that these payments still were exceeded by the interest received on U.S.-owned foreign financial assets. But that excess has been shrinking—from $10.0 billion in 1982 to $6.2 billion last year—and, if current trends continue, eventually will disappear altogether.

In the process, our traditional surplus on all nontrade transactions—business services and investment income—will likewise disappear and the overall payments deficit will widen further. But a larger deficit must be matched by larger capital inflows—which, in turn, will produce larger income payments to foreigners. While foreigners may well channel some of those payments into productive investments in this country or into purchases of U.S. goods and services (or a combi-

nation of both), at some point in the future they may decide to do neither.

Thus, one of the risks of continued growth in U.S. foreign liabilities is that such growth will sooner or later erode foreign confidence in how we manage our domestic economic affairs. Specifically, the more indebted the United States becomes to the rest of the world, the more visible and shaky the large Federal budget deficit will appear and the greater the overall threat it would pose to foreign confidence.

To keep the current-account deficit (and hence capital inflows) from increasing further requires a correction in the value of the dollar and a major pickup of economic growth in Western Europe so that our trade account can swing back into surplus. But as foreign investors become aware of the need for our trade performance to improve they also become aware of the inevitability of a substantial correction in the dollar exchange rate. This, then, poses a genuine dilemma for our net debtor position—foreigners must continue to regard dollar investments attractive, while the dollar needs to decline sufficiently to improve the trade account and keep the current-account deficit from widening.

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FOREIGN CAPITAL EXPENDITURES BY U.S. COMPANIES
Little Change in 1986

Investment abroad in 1986 by United States manufacturing companies appears to be on a steady course, not materially changed from 1985. The latest survey (October 1985) by The Conference Board shows that 42% of the respondents plan to spend more in 1986 than in 1985. This is exactly the same percentage that planned to spend more when asked in April 1985 about their intentions for 1985 (in comparison with 1984).

Offsetting this, however, is the sharply increased percentage of companies that plan to spend less in 1986. About the same percentage of respondents expect 1986 expenditure levels to be about the same as in 1985.

As a result, it appears likely that about the same money expenditures for plant and equipment will be made in 1986 as in 1985. Continued price inflation, of course, will continue to push up expenditures.

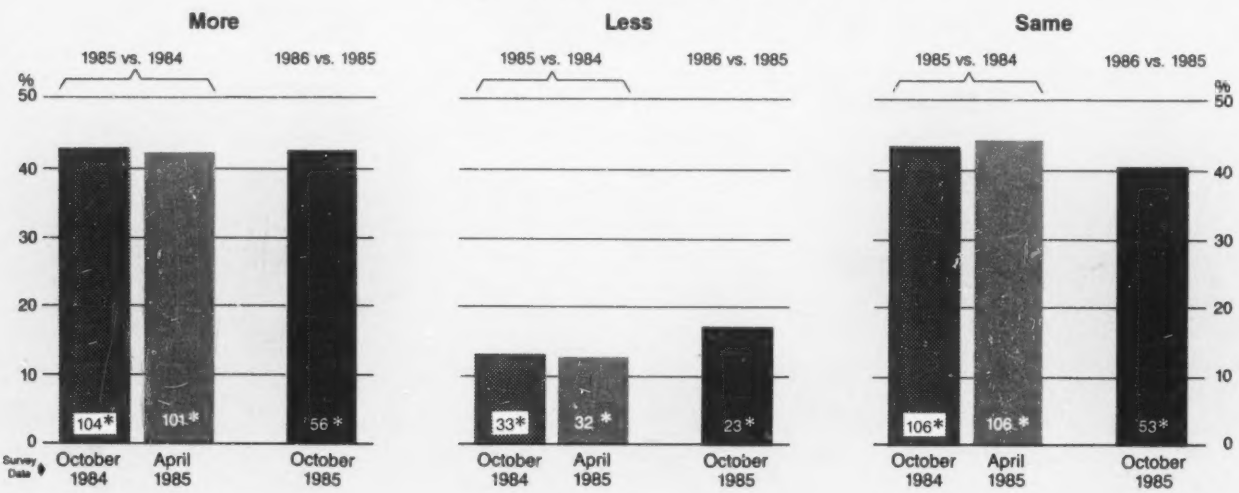
The Conference Board's October 1985 survey appears to reinforce the Department of Commerce's findings in June 1985. Manufacturing and petroleum companies responding to that survey indicated that they expect to spend nearly 3% more in 1986 than in 1985. This increase is actually well under the current worldwide rate of inflation. So this low figure points to a very cautious attitude on the part of the U.S. manufacturers, as does this Conference Board survey.

Reasons for Foreign Investment

Those companies planning to spend more offered much the same reasons for 1986 as in years past. Goals of pro-

Manufacturers' Plans for Plant and Equipment Expenditures Outside the United States

Number and Percent of Companies Planning to Spend:



*Number of Companies

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tecting old markets or opening new markets were uppermost in the minds of the respondents, as in the past. Two other factors that grew sharply in importance, however, might provide more of a clue to the present attitude of U.S. multinationals in manufacturing. Both reasons compare the United States to foreign countries—and disadvantageously.

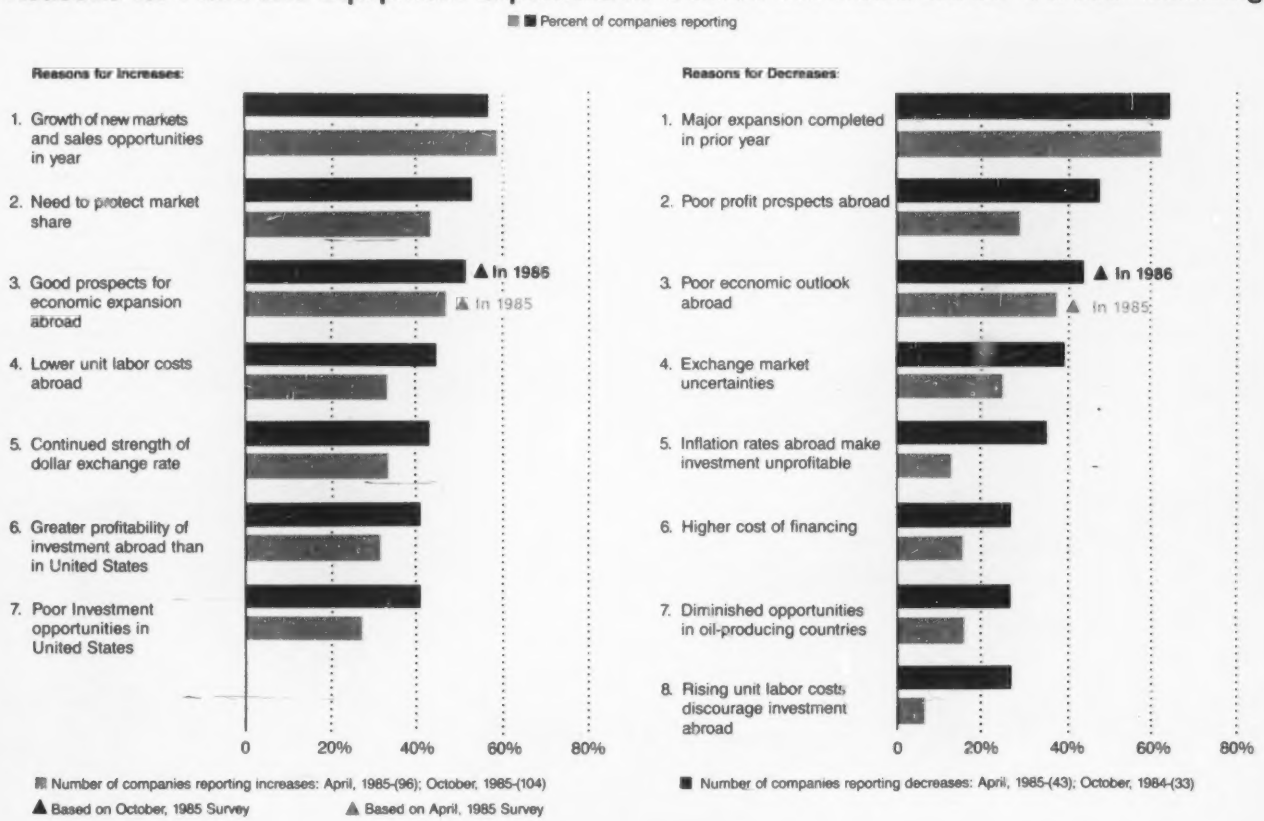
The "Greater profitability of investment abroad than in the United States" and "Poor investment opportunities in the United States" were each mentioned by 41% of the respondents. In the last Conference Board survey of April 1985 (and generally in earlier surveys), these reasons were not noted by so high a percentage of the companies.

Data on "Spending Plans for Plant and Equipment Outside the United States by Industry" were not collected in the survey of October 1985.

Needless to say, not all respondents see the same scene when looking abroad. Of those companies planning to spend less abroad, an increased percentage mentioned the factors of "Poor profit prospects abroad" and "Continued poor economic outlook." There too the implied comparison is with the United States, but those companies reached the conclusion that less spending was warranted abroad now than in 1985.

J. Frank Gaston

Reasons for Plant and Equipment Expenditures Outside the United States—All Manufacturing


Percent of companies reporting
Reasons for Increases:
1. Growth of new markets and sales opportunities in year
2. Need to protect market share
3. Good prospects for economic expansion abroad
4. Lower unit labor costs abroad
5. Continued strength of dollar exchange rate
6. Greater profitability of investment abroad than in United States
7. Poor Investment opportunities in United States
▲ In 1986
▲ In 1985
0
20%
40%
60%
80%
Reasons for Decreases:
1. Major expansion completed in prior year
2. Poor profit prospects abroad
3. Poor economic outlook abroad
4. Exchange market uncertainties
5. Inflation rates abroad make investment unprofitable
6. Higher cost of financing
7. Diminished opportunities in oil-producing countries
8. Rising unit labor costs discourage investment abroad
▲ In 1986
▲ In 1985
0
20%
40%
60%
80%
Number of companies reporting increases: April, 1985-(96); October, 1985-(104)
▲ Based on October, 1985 Survey
▲ Based on April, 1985 Survey
Number of companies reporting decreases: April, 1985-(43); October, 1984-(33)

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